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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Implications of the Recent Iraqi-Soviet Oil Agreements

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CENTRAL INTELLIGENCE AGENCY
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INTELLIGENCE MEMORANDUM

Implications of the Recent Iraqi-Soviet Oil Agreements

Introduction

In June and July 1969, Iraq and the USSR signed two agreements to assist in developing a national oil industry in Iraq. The agreements are not unique for either party, but they are of special interest because Soviet participation introduces a new element in Iraq's longstanding dispute with the Western-owned Iraq Petroleum Company (IPC). Moreover, the involvement of the USSR again raises the specter of Soviet access to, or control of, Middle East oil.

This memorandum analyzes the probable aims of the agreements, the prospects for success, the gains that might accrue to Iraq and the USSR, and the possible effects on the IPC.

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The June Agreement

1. The first of the two agreements with the USSR is designed to aid Iraq in oil exploration activities. The agreement was signed in Baghdad on 21 June 1969 between the government-owned Iraq National Oil Company (INOC) and the Soviet state trading organization, Mashinoeksport. Mashinoeksport will provide oilfield equipment and related technical assistance for installing and operating the equipment and will arrange for training Iraqi personnel in Iraq and in the USSR. The total value of the goods and services authorized under the agreement is $72 million. The agreement, effective for seven years, will be implemented through a series of contracts to be negotiated as required. INOC will pay 10 percent of the value of each contract at the time of signing and 15 percent upon submission of shipping documents. The USSR will provide a trade credit for the remaining 75 percent to be repaid over five years in equal annual installments with interest at 3 percent per annum. Payments are to be made in accordance with the Iraqi-Soviet trade agreement of 1958, which provides for periodic settlement of accounts in convertible currencies.

2. The June agreement appears to be Iraq's first step in obtaining equipment and acquiring skills for developing oil resources in acreage previously held by the IPC and now assigned to INOC. Al Halfayah (see the map), the only area mentioned specifically in the agreement, has not been explored, [redacted] 25X1 25X1 There is nothing in the text of the agreement to indicate that the USSR will participate in the INOC operation or in the disposal of any oil that might be discovered.

3. The first contract signed under the June agreement has an estimated value of $9.5 million and covers the supply of geological and geophysical drilling equipment and related materials sufficient for two years' activities, presumably at Al Halfayah. A related agreement of unspecified value provides for "technical assistance" for a period of three years.

The July Agreement

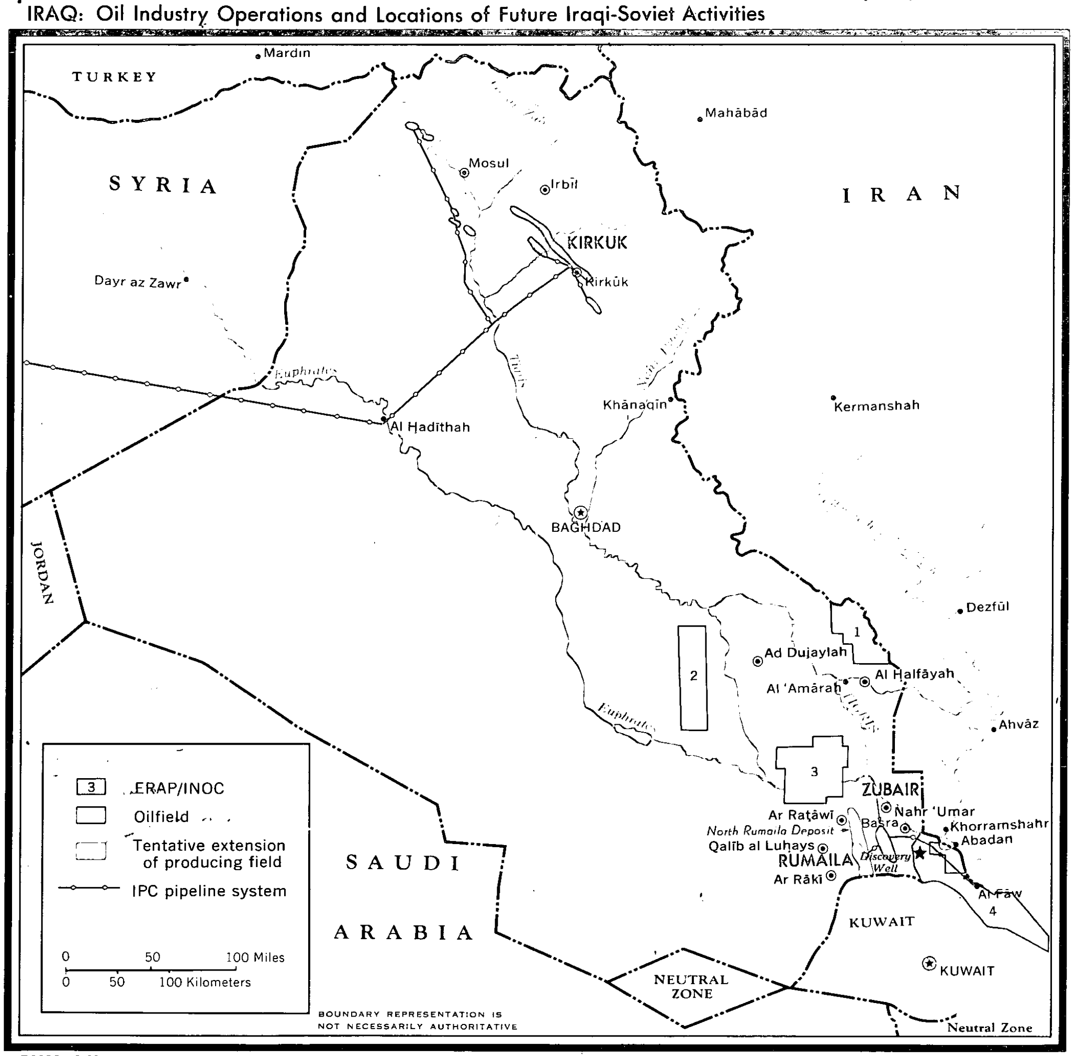
4. The second agreement provides for Soviet assistance both for the exploitation of the North Rumaila field and for the survey of unexplored areas.* It was signed in Moscow on 4 July 1969 by the two governments, rather than by state agencies as in the June agreement. Under the July agreement the USSR extends credit amounting to $67 million, with interest at 2.5 percent per year, for Soviet technical and economic assistance for development of Iraqi oil resources. The agreement will be implemented through separate contracts. The portion of credit used before 1 January 1973 is to be paid in seven equal annual installments beginning on that date. The part used after 1 January 1973 is to be repaid in seven equal annual installments beginning one year after that date. Both principal and interest are repayable in Iraqi oil valued at prices prevailing in the open market, but settlement will be made in convertible currencies if Iraqi oil is not available for repayment. The provision for repayment in oil is consistent with the new types of contractual arrangements made between national oil companies in the Middle East and foreign oil companies. It differs, however, from Soviet assistance agreements with other countries, which do not specifically mention repayment in oil.

5. The USSR will restore existing "shut-in" wells and construct oil-gathering facilities at the North Rumaila oilfield and will lay an 80-mile pipeline to the port of Al Faw on the Persian Gulf and build storage facilities there. Development work is to be completed and operation of North Rumaila

* *The North Rumaila deposit was part of the original concession granted to the IPC, the foreign-owned consortium that developed Iraq's oil economy. The deposit was included in the area reclaimed by Iraq under Law 80 of 1961, but IPC has never agreed to relinquish the deposit.* [redacted] 25X1

[redacted] 25X1

IRAQ: Oil Industry Operations and Locations of Future Iraqi-Soviet Activities



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at an initial oil production rate of 100,000 barrels per day (bpd) is to begin in the first quarter of 1972. The possibility of increasing production to about 360,000 bpd at an unspecified future date also was mentioned in the agreement.* The agreement does not describe the nature of Soviet responsibilities for the production and disposal of North Rumaila oil or indicate whether or not the USSR will be an exclusive contractor on the project.

6. The USSR also will prepare a program for the survey of acreage in southern Iraq at Nahr Umar, Qalib al Luhays, Ar Raki, and Ad Dujaylah where the presence of oil is suspected. If the survey at these locations and at Al Halfayah (mentioned in the June agreement) justifies development, the USSR will "examine the possibility of providing technical assistance in implementing" a development program. Moreover, the USSR will provide technical assistance in preparing for operation of the Ar Ratawi oilfield, which is contiguous to Rumaila.

Other Agreements

7. The Iraqi-Soviet agreements are not unique for either country. Iraq currently has agreements outside the framework of its concessionary arrangement with the IPC. Since November 1967, Entreprise de Recherches et d'Activités Pétrolières (ERAP), a French state-owned enterprise, has conducted exploratory work under a service contract in areas of southern Iraq that previously were held by IPC. ERAP will recover its exploration costs in oil, if any is found, and would assure a market for most of the oil produced. Late in 1968, ERAP announced an oil discovery. [redacted]

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* *These production goals seem realistic. Proved oil reserves in North Rumaila probably exceed 10 billion barrels, representing between 25 and 50 percent of Iraq's total proved reserves.* [redacted] *the deposit could be developed to produce between 400,000 and 500,000 bpd in two or three years.*

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8. Two other agreements involve Yugoslavia and East Germany. In mid-1969, INOC and INA (the Yugoslav oil monopoly) signed a technical cooperation agreement to assist INOC in oil exploration and production activities and the training of Iraqi personnel. (The details of this agreement were not published.) The East German agreement, also signed in mid-1969, extended a credit of about $84 million to be used over the period 1969-74 for the construction of unspecified plants for various Iraqi ministries, including the Ministry of Oil. This credit is repayable over 12 years at an interest rate of 2.5 percent per annum beginning one year after the first project is operational. Seventy percent of the repayment is to be in crude oil and the remainder in goods produced by the plants to be constructed.

9. For its part, the USSR has agreements with the Arab states of Algeria, Egypt, and Syria involving economic and technical assistance for their oil industries. The value of the agreements with each of these states, however, is substantially less than the value of either of the Soviet agreements with Iraq.

Implications of the Agreements for Iraq

10. The Iraqi-Soviet agreements may help Iraq to gain experience in oilfield operations and to fulfill its plans to develop directly acreage formerly held by the IPC. The agreements will not change Iraq's oil economy or significantly reduce its heavy dependence on the IPC.* It is not possible to predict the degree of success that might be achieved in the areas of southern Iraq where exploratory activities are planned. North Rumaila, however, probably could be developed without difficulty to

In 1968 the IPC produced oil at a rate of about 1.5 million bpd and its exports earned $487 million in hard currencies for Iraq. Almost all of this oil was exported to markets controlled by the shareowners of the IPC. Moreover, over 1 million bpd of the IPC production originates in the north, where Kurdish dissidents are most active and where the current government's control is least effective.

produce at the planned initial rate of 100,000 bpd in 1972 and the subsequent level of 360,000 bpd, perhaps three to five years later. At the initial rate of production, Iraq could expect gross revenues of about $34 million; debt servicing would reduce this by about $12 million.*

11. Iraq probably would have no trouble marketing the quantities of North Rumaila oil planned for the first phase of production either to the USSR (for its own use or for resale to other Communist countries) or to small, independent refiners in the Free World for hard currencies. Under either circumstance the proceeds could be applied to meet the scheduled financial obligations of the agreements.

12. The quantity of oil to be produced at the end of the second stage may be more difficult to market because it may be greater than the Communist countries would be able to accept on a continuing basis. It is unlikely that the Communist countries would use their scarce hard currencies for purchase of Iraqi oil after Iraq had repaid the outstanding credits. They might be willing to buy part of the oil on a barter basis. Iraq, however, would prefer to sell its oil to Free World countries for hard currency. The amount it would be willing to barter thus depends on its success in hard currency sales.

13. The worldwide oil surplus that is now developing probably will continue beyond the mid-1970's, and Iraq could have trouble finding markets for INOC

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* *If Iraq were to settle the dispute with the IPC, [redacted] the government could expect additional revenues of $890 million in the period 1970-74. This estimate includes a lump sum payment of $168 million in 1970 in settlement of all outstanding financial issues, changes in accounting procedures which would increase revenues by $33.6 million annually, and additional revenues from an overall increase in total oil exports of 7 percent annually.* 25X1

oil in the Free World. The prospects for disposing of this new oil are complicated further by the new oil that ERAP may produce in Iraq. The government could, however, defer the second stage of North Rumaila development until markets were assured.

Possible Gains for the USSR from the Agreements

14. The two agreements offer the USSR an opportunity to further its influence in Iraq and to gain access to some Middle East oil. The June agreement will provide the USSR with a new, though small, source of hard currency, and the July agreement will provide it with a volume of oil that it can use profitably. The rate of growth of Soviet oil production is expected to decline until the mid-1970's, when sizable quantities of domestic oil should become available from resources now being developed in Western Siberia. This decline, in the face of increasing demand at home and in Eastern Europe, will probably prevent the growth of, or may even reduce, Soviet hard currency oil exports to the Free World. Oil from Iraq could be supplied, however, to the oil-deficient Soviet Far East, to North Korea when a new refinery is completed there, and even to the countries of Eastern Europe.* This would free corresponding quantities of the USSR's oil for export to its Free World markets.

15. Implementation of the agreements has some potential drawbacks for Iraq as well as for the USSR. Much of the Soviet work in foreign oil activities has been below the standards of Western oil companies. Equipment generally has been inferior to that available from the West, technology has been criticized as outdated, and the work rarely has been completed on schedule.** Moreover, the traditional

* *In spite of higher transport costs resulting from the closure of the Suez Canal, Bulgaria and Cuba imported crude oil from Egyptian sources in the Red Sea in 1969.*

** *The Iraqi Director of Industrial Design is critical of the July agreement, citing previous difficulties with Soviet deals, high costs, and failure to deliver material and equipment on time.*

Soviet stubbornness in negotiating contracts may delay or even preclude the full implementation of the agreements with Iraq. There is evidence that contract negotiations pursuant to these agreements already have created problems. Although the USSR should be able to develop successfully the North Rumaila field, where the IPC had already done extensive work, failure there or elsewhere in Iraq would damage seriously the Soviet image as an alternative to Western oil companies in Iraq and elsewhere in the Middle East.

Possible Effects on the Iraq Petroleum Company

16. The effects of the Iraqi-Soviet agreements on the relationship between Iraq and the IPC are difficult to judge. In mid-July 1969 an IPC working group concluded that the Soviet-Iraqi agreement did not completely eliminate the possibility of an Iraq-IPC deal on North Rumaila. This judgment followed reports that IPC personnel in Iraq were being treated with a deference and cordiality not evident in recent years; it followed also the settlement of the potentially serious Basra cargo/port dues dispute on terms readily acceptable to the IPC. The extent to which these incidents influenced the IPC conclusion is not known, but available evidence and the widespread publicity attending the signing of the Iraqi-Soviet agreements do not support IPC's apparent optimism. It is unlikely that North Rumaila would revert to IPC under any new agreement with the Iraqi government. IPC might, however, retreat to the role of a contractor to the Iraqi government.

17. The IPC probably will resort to legal pressures if it is excluded permanently from North Rumaila. The company rejects as illegal the provisions of Iraqi Law 80, and it has previously threatened legal action against any party purchasing or transporting oil from North Rumaila. So long as North Rumaila remained inactive and the possibility existed that the IPC could retain or recover its interest there, no action was taken. If the July agreement now closes the door on a settlement, the IPC may decide to act to protect its claim to North Rumaila and to discourage other oil-producing states from following Iraq's example. Legal action against

the USSR, other Communist countries, or Free World oil companies that might traffic in oil from North Rumaila is unlikely to be successful. Moreover, IPC operations elsewhere in Iraq are vulnerable to government harassment if the IPC pursues its threats of legal action.

18. The mutual benefits of maintaining current relations, however strained, probably will preclude a complete break between the government and the IPC during the next few years. The capability to deliver one million bpd of oil from northern Iraq to the eastern Mediterranean for markets in Western Europe gives the IPC an important competitive advantage, particularly while the Suez Canal is closed. At the same time, the sale of this oil is the principal source of Iraq's earnings of hard currency, and Iraq would have difficulty marketing the quantity of oil that the IPC is producing there.

Conclusions

19. The Iraqi-Soviet agreements do not represent a serious new threat to normal world oil commerce or to the IPC. Nor do they represent any significant change in either Soviet or Iraqi policies regarding oil; the USSR has assistance agreements with other Middle East states and Iraq has agreements with countries other than the USSR. Although a small segment of Iraq's oil economy will become oriented to the Communist world, Iraq will not abandon its profitable commercial relationship with the Free World oil industry. Iraq will continue to depend on the IPC for the bulk of its revenues and will not jeopardize the potentially rewarding arrangements with France's ERAP. Conversely, IPC probably will seriously consider granting further concessions in order to preserve its valuable assets in Iraq.

20. The USSR, in addition to expanding its political and economic presence in a radical Arab state on the Persian Gulf, could have access to oil on a barter basis that would be sold in Free World markets for hard currency or would release a similar quantity of Soviet oil for those markets. Successful implementation of the agreements might further encourage

other Arab states to develop sources of oil independent of Western oil interests. Iraq itself would have access to small quantities of oil without having to share profits with foreign oil firms. Also, the agreements may help to develop skills and know-how within Iraq for further growth of INOC.